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Global Politics Take Backseat To Trade Frictions At Bush-Miyazawa Summit

Judging by op-ed articles and television commentaries in both the American and Japanese media, the January 8 and 9 meetings between President Bush and Prime Minister Kiichi Miyazawa in Japan may be viewed by historians as a case where domestic politics forced the "foreign policy president" to swerve off the diplomatic high road. When preparations for a planned late November summit began last year working-level officials in both Washington and Tokyo spoke in an upbeat manner about the meeting. The first state visit to Japan by an American president since former President Ronald Reagan's November 1983 trip would spotlight the potential for bilateral cooperation in tackling the myriad problems of a changing international order, they felt. The White House's decision in early November to postpone this trip signaled a change from a summit of "high politics" with America's most important Asian ally to one imbued with upcoming election year political pressures (see *JEI Report* No. 43B, November 15, 1991).

As portrayed by the media the Bush-Miyazawa meetings, rescheduled for January, became a glorified round of trade negotiations that may have created more political problems -- for Mr. Bush, in particular -- than they apparently set out to solve. Perhaps even more troubling is the prospect that the January 7-10 Japan leg of Mr. Bush's 12-day Asian trip may have undermined the original aim of fostering a spirit of goodwill and cementing ties between Washington and Tokyo.

While Michigan Democrats were among the most vocal critics on Capitol Hill, they were not alone in criticizing the president's efforts in Japan. Sen. Lloyd Bentsen (D, Texas), chairman of the Senate Committee on Finance, characterized the tour as "obviously a political trip to assist [Mr. Bush] in his reelection campaign." He added that his committee would hold hearings in late January to review the agreed-upon trade concessions, which he called "too little, 10 years too late." Rep. Gephardt cautioned: "While the president sent the right message to the Japanese people about the pivotal role of economics in our bilateral relationship . . . what really matters is whether we get results."

Several candidates for the Democratic and Republican presidential nomination also derided President Bush's approach to Tokyo and framed it as another example of what they characterize as the administration's poor handling of this country's economic problems. Conservative commentator and candidate for the Republican presidential nomination Patrick Buchanan labeled the trade concessions agreed to in Tokyo "puny and piddling," while Democratic candidates, including Arkansas Gov. Bill Clinton and Sen. Robert Kerrey (D, Neb.), accused President Bush of putting the United States in the position of begging Japan for favors.

As this country's economic problems loom larger for many Americans, Washington watchers note that the Bush administration's trade policies toward Japan are seen as an area of real vulnerability for the president. Congressional observers contend that Democrats will be quick to challenge the administration in this arena. The 1992 predictions on Capitol Hill are for a rocky year in U.S.-Japan trade relations.

Margo Grimm

Yen Had Good Year In 1991

Even though the Japanese economy decelerated rapidly and domestic financial markets became embroiled in scandal in 1991, at least one key economic indicator -- the yen -- turned in a strong performance. On an annual average basis the Japanese currency appreciated 7.6 percent against the dollar, reversing a two-year slide. Its average value for the year of Y134.6=$1.00 was the second highest on record, just behind the Y128.2 recorded in 1988 (see Table 1).

Table 1: **Yen-Dollar Exchange Rate, 1986-91**

(monthly average; Tokyo interbank market)

	1986	1987	1988	1989	1990	1991
January	Y200.0	Y154.5	Y127.6	Y127.2	Y145.1	Y133.9
February	184.6	153.5	129.2	127.8	145.5	130.5
March	178.8	151.5	127.3	130.4	153.1	137.2
April	175.6	143.0	125.0	132.1	158.5	137.1
May	166.9	140.5	124.8	138.4	153.5	138.1
June	167.8	144.5	127.1	143.8	153.8	139.8
July	158.7	150.2	133.1	140.7	149.3	138.0
August	154.1	147.6	133.6	141.1	147.4	136.9
September	154.8	143.0	134.4	145.1	139.0	134.6
October	156.0	143.5	129.0	141.9	129.7	130.7
November	162.7	135.3	123.2	143.5	129.1	129.7
December	162.1	128.4	123.6	143.6	133.7	128.1
Annual Average	168.5	144.6	128.2	138.0	144.8	134.6

In retrospect the yen's run-up actually began in 1990. After hitting a nadir on a monthly basis in April of that year, the Japanese currency trended higher, although March to June of 1991 ran counter to this pattern. The yen ended the year at Y124.8=$1.00, close to its all-time daily high of Y121.15 set November 24, 1988. Further strengthening in the early weeks of this year has brought the yen closer to that peak, with the Japanese currency closing January 6 at Y123.35, for example.

Against nondollar currencies the yen was similarly strong in 1991 (see Table 2). Fluctuations vis-a-vis Asian currencies were particularly interesting because they tended to debunk speculation in the U.S. media last year about the emergence of a bloc of Asian nations using the yen as a convenient means of settling international transactions. (For details of this concept in the context of internationalization of the yen, see *JEI Report* No. 38A, October 5, 1990.) Such an arrangement normally would imply that the currencies of the participating nations would fluctuate less against the yen than against the dollar. In fact, although some currencies, such as the Singapore dollar, were quite stable against the Japanese currency (which implies greater fluctuation against the dollar), most showed the opposite pattern. They moved against the yen in the same direction and in roughly the same magnitude as did the American dollar, repeating a pattern evident in 1990 as well (see *JEI Report* No. 2B, January 18, 1991). If anything, this result suggests that the currencies of South Korea, Hong Kong and Australia, for example, are more closely tied to the dollar than to the yen.

Table 2: **Changes in the Yen Against Selected Currencies, 1990-91**

(other currencies in terms of yen at yearend)

	1990	1991	Percent Change
German Deutsche mark	Y90.84	Y82.38	10.3%
British pound	262.09	233.31	12.3
Australian dollar	104.91	94.85	10.6
Canadian dollar	117.07	108.00	8.4
Korean won	0.19	0.17	10.3
Singapore dollar	78.25	77.01	1.6
Taiwan dollar	5.10	4.89	4.2
Hong Kong dollar	17.41	16.05	8.5
U.S. dollar	135.80	124.80	8.8

The yen's overall strengthening at a time when the Japanese economy was showing signs of weakness is not as surprising as it may seem. Compared to Washington, Tokyo was slow to ease monetary policy in 1991; accordingly, interest rates fell earlier in this country. In addition, Japan's relatively low rate of actual and probable inflation suggests that real rates were almost as high as nominal ones. As a result, Japanese securities attracted international investors, creating a demand for the yen and boosting its value. This relationship was exemplified by a sequence of events at yearend. After the Federal Reserve Board engineered a 1 percentage point cut in the discount rate December 20, the Bank of Japan trimmed half a point off its rate 10 days later (see *JEI Report* No. 1B, January 10, 1992). As expected, international currency markets responded by bidding up the value of the yen through at least the first week of 1992.

Predictions concerning the yen in 1992 vary tremendously, as usual. A *Wall Street Journal* survey of 42 American economists came up with a June 30 average value for the yen of Y128=$1.00 and a yearend value of Y132=$1.00, although a handful of respondents thought that the yen could be as weak as Y150 by yearend or as strong as Y120. A survey of 47 Japanese economists by the *Journal*'s Japanese counterpart, *Nihon Keizai Shimbun*, asked each expert to express the range over which

the yen and the dollar would vary in 1992. Ten gave exactly the same answer: a high of Y120 and a low of Y140. The average high vis-a-vis the dollar, however, was Y117.55 and the average low Y140.59. Taking the midpoint of the average high and the average low as an estimated consensus forecast gives a prospective value of Y129.1 for 1992, remarkably close to the June and December forecasts of the American economists.

Currency values are notoriously difficult to forecast, in part because speculators push actual values close to credible predicted values very quickly. Hence, forecast values tend to become starting points during the forecast period rather than accurate estimates of trends. In 1991, however, the Japanese consensus forecast, calculated as described above, missed by a mere half yen the actual average value for the year of Y134.6=$1.00; the consensus American forecast was off by three-and-a-half yen. A problem with 1992 consensus forecasts, especially in the United States, is that they discount too strongly the possibility that the yen will establish a new high, breaking the Y120=$1.00 barrier. The strong momentum that began in 1990 may not yet have run its course, particularly since central bankers in both countries appear to have lost their aversion to a weak dollar. Nevertheless, inevitable fluctuations over the course of the year are likely to imply an average value of the Japanese currency in 1992 that is slightly stronger than Y130=$1.00.

Douglas Ostrom

Tokyo Stock Market Trapped In Bears' Hug

As if recovering from a very bad hangover, Japan's equity markets ended 1991 still working off the effects of the speculative investment binge of the late 1980s. According to data on the most recent trading, the "morning after" apparently will last well into 1992 as far as Japanese domestic stock market activity is concerned. While this bearish outlook may succor government policymakers worried about the return of speculative fever, those concerned about lagging domestic economic growth are less encouraged.

Compared to the record-smashing year of 1989, the past two years have been sharp disappointments. The Tokyo Stock Exchange's Nikkei average fell from a record high of 38,915.87 on December 29, 1989 to 20,221.86 on October 1, 1990 before recovering to 23,848.71 on December 28 that year (see *JEI Report* No. 8B, March 1, 1991). The TSE began 1991 in a hopeful mood, reacting calmly to the outbreak of actual combat in the Persian Gulf and joining other major bourses in a global rally when it became clear that the multinational effort to liberate Kuwait from Iraq would be brief and successful for the allies. With the conflict out of the way, according to Japanese bulls, the global economy would resume its forward march thanks, in part, to moderate and stable prices for crude oil. Unfortunately, the stimulative impact amounted to no more than a ripple. In Europe and the United States economies sagged under the weight of domestic and/or regional problems. Japanese bulls still expected the continued strength of personal consumption and capital investment to keep the domestic economy from being pulled down by foreign troubles. Their optimism proved unfounded.

Although the Nikkei Average hit 27,146.91 on March 18, the rest of the year would bring nothing but bad news for investors and brokers. Despite July 1 and November 14 cuts in the discount rate, the market plunged below 22,000 in August and managed only a modest rally in October (closing at 25,044.24 on November 1) before sliding down to 22,983.77 at the close of the year's last trading day, December 30. Just as important, daily average trading volume dropped for the third consecutive year. From the record of just over 1 billion shares a day in 1988, the average plunged to 483.9 million shares changing hands daily in 1990 and then to 372.9 million shares in 1991, the lowest level since 1982. Another indicator of market stagnation was the low ratio of total market turnover to the total number of shares outstanding. Last year's mark of 28 percent (for first section TSE stocks) represented the smallest figure since 1955 and was precipitously lower than 1988's 100 percent level.

The news is not all bad, according to Tokyo bulls. The inflow of foreign investment should continue to expand in 1992 -- it reached a record high of about $68 billion in 1991, according to a Japanese securities company -- since prices are at relatively low levels and price/earnings ratios more reasonable than in the last bull market. Moreover, the cuts in the discount rate since mid-1991 should begin to buoy business activity by the second half of 1992, analysts say; that outlook has generated hopes of higher corporate profits. Easier credit also could relieve anxieties about a potential real estate market crash since it would relieve pressure on firms with large real-estate loan burdens. Renewed growth in the United States and Europe also is expected to help the market's mood. With upper house elections coming in the middle of this year, some analysts predict that the ruling Liberal Democratic Party will advocate more fiscal stimulation, which would benefit domestic building materials and construction companies. The acuity of the bulls' crystal balls has been disproved in the past, however. Bearish investors seem to have a clearer vision of the market's immediate future.

Jon Choy

President's Asian Trade Offensive Leaves Japan's Automotive Makers On Defensive

Japan's automotive industry is in for rough political sledding in the United States this year. Detroit's multiple problems made that outcome all but inevitable before the chairmen of the Big Three U.S. motor vehicle companies met with their Japanese counterparts in Tokyo January 8-9; those unprecedented meetings sealed it. The heads of Chrysler Corp., Ford Motor Co. and General Motors Corp. went to Japan looking for a quick fix to the lopsided transpacific trade in automotive products. They knew, or should have known, that the Japanese side would not commit to specific cuts in the bilateral automotive trade deficit. Yet the Big Three executives returned home angry, with Ford chairman Harold Poling ready to join Chrysler's Lee Iacocca in backing mandated reductions in the U.S.-Japan trade imbalance over five years and Robert Stempel, head of GM, not ruling out his support.

The three American automotive heads did not leave Japan empty-handed, although that is the impression they gave. The five biggest Japanese motor vehicle manufacturers said they intended to buy $17.8 billion worth of U.S. parts in FY 1994 (see Table 1), nearly $9.3 billion above FY 1990's

Table 1: **Projected Purchases of U.S. Parts by Japan's Top Five Automotive Makers**

(in millions of dollars)

	Toyota	Nissan	Honda	Mazda	Mitsubishi	Total
FY 1990 (Actual)						
U.S. Operations	$1,900	$900	$2,520	$968	$527	$6,815
Japanese Operations	700	400	280	218	155	1,753
Total	2,600	1,300	2,800	1,186	682	8,568
FY 1994 (November 1991)						
U.S. Operations	3,600	2,780	4,150	1,890	1,130	13,550
Japanese Operations	1,000	520	350	270	270	2,410
Total	4,600	3,300	4,500	2,160	1,400	15,960
FY 1994 (January 1992)						
U.S. Operations	3,820	2,900	4,380	1,900	1,200	14,200
Japanese Operations	1,460	800	560	400	400	3,620
Total	5,280	3,700	4,940	2,300	1,600	17,820

Source: Company announcements

aggregate procurement level and $1.9 billion more than they had planned to source from American suppliers as part of the Ministry of International Trade and Industry's Business Global Partnership program (see *JEI Report* No. 44B, November 22, 1991). Most of the targeted purchases will be used by the U.S. production units operated by Toyota Motor Corp., Nissan Motor Co., Ltd., Honda Motor Co., Ltd., Mazda Motor Corp. and Mitsubishi Motors Corp. That will help insure that the domestic parts content of the vehicles made in the United States by the five reaches 70 percent by March 1995 compared with approximately 50 percent in FY 1990.

More important in the current political environment, the projected level of parts purchases for transplant cars and trucks could make a dent in the U.S.-Japan automotive trade deficit. Parts represented $9.9 billion of this country's $30.4 billion shortfall in automotive products in 1990, according to one of several methods of calculation, with the United States purchasing $10.6 billion worth of parts from Japan while sending only $764 million the other way. If the five automotive makers do boost domestic sourcing for their American factories to $14.2 billion in FY 1994, those purchases would displace up to $7.4 billion in parts that otherwise would be imported from Japan based on 1990 car and truck production levels and parts purchasing patterns. The additional $1.9 billion in parts the five Japanese companies plan to buy for use at home also will provide some bottom-line relief.

To make sure that "traditional" American parts producers win a big chunk of the extra business the five Japanese motor vehicle manufacturers promised to strengthen or expand existing efforts to help U.S. firms become part of their supplier ranks. For companies that already meet Japanese car and truck makers' quality, price and delivery requirements the key to gaining additional sales could be the pledge to promote the number of design-ins. (According to the government's "action plan," Japanese automotive makers had 332 ongoing design-ins with U.S. parts suppliers as of January 1991; another 271 had been completed.) For domestic parts firms still struggling to meet the demanding standards of Japan's motor vehicle industry the five biggest members said they would continue existing cooperative efforts (see *JEI Report* No. 30B, August 9, 1991).

Plans were vague for narrowing the huge gap between the value of cars and trucks Japan ships to the United States ($21.5 billion in 1990) and the flow the other way ($996 million the same year). Japanese automotive industry executives acknowledged as much before and after their meetings with the leaders of the Big Three, but they placed the blame squarely on GM, Ford and Chrysler. Japanese manufacturers and their dealers are prepared to supplement Detroit's own sales efforts in Japan, company spokesmen said, noting that dealerships now are free to handle more than one firm's vehicles and parts. There is a catch: U.S. competitors must bring the quality of their products up to the Japanese average and do more to tailor their exports to the Japanese market; otherwise, the cars just will sit on dealer lots.

Although Japan's five largest automotive producers did not want to be specific about their plans for handling American-made cars, the government prodded them into coming up with some numbers. Honda, which has been marketing part of Chrysler's Jeep line for the last year, said it was targeting Cherokee and Wrangler sales at 1,200 units in 1994, up from the 437 sold in 1991. Mitsubishi Motors also indicated it would help Chrysler raise sales in Japan by trying to sell 6,000 of the number-three U.S. automaker's cars in FY 1995. For its part Mazda, which makes Ford-badged cars at its Hiroshima complex for sale in Japan, plans to import 4,500 Ford Probes, Tauruses, Thunderbirds and Lincoln Continentals in the upcoming fiscal year, more than double the number for FY 1990; last year it sold 1,676 imported Fords. In addition, Nissan said it was willing to handle Ford vehicles for the first time; the second-largest Japanese car company has penciled in sales at 3,000 units a year. Finally, Toyota stated that it was prepared to sell about 5,000 GM products a year through its dealer network.

Big Three car sales in Japan, which totaled 13,711 vehicles in 1991, would more than double over the next three years if the Japanese industry's distribution plans are realized. But that still would

be below the number of Mercedes-Benzs (34,187) or BMWs (33,798) sold last year. Moreover, Detroit's share of the Japanese car market would remain miniscule (see Table 2).

Table 2: **Car Registrations in Japan by Make, 1986-90***

(in units)

	1986	1987	1988	1989	1990
Japanese Makes					
Toyota	1,382,581	1,453,796	1,633,171	1,760,907	1,893,422
Nissan	765,738	764,633	860,680	996,988	1,056,920
Honda	304,946	337,094	401,070	457,559	514,709
Mazda	194,139	198,561	217,872	296,145	398,951
Mitsubishi	146,261	158,323	180,874	232,978	314,917
Daihatsu	87,609	75,767	90,139	157,046	254,975
Suzuki	63,626	62,148	64,546	140,201	247,675
Fuji	73,699	68,520	79,791	138,107	164,765
Isuzu	59,067	58,207	55,633	43,394	34,619
Japanese Makes	3,077,666	3,177,049	3,583,776	4,223,325	4,880,953
Imported Makes					
American Imports	2,345	4,006	14,511	19,084	28,602
General Motors	1,829	2,829	4,841	7,231	8,513
Ford	406	863	3,809	5,967	6,030
Chrysler	106	300	443	973	1,432
Honda	0	9	5,395	4,697	7,534
Diamond-Star	0	0	0	23	2,886
Toyota	0	0	0	146	2,109
Other American Imports	4	5	23	47	98
German Imports	53,916	74,289	91,648	120,293	137,442
Mercedes-Benz	13,820	18,749	22,625	31,511	38,844
Volkswagen	16,067	23,740	27,947	34,674	36,770
BMW	15,250	21,015	26,826	33,076	36,527
Audi	7,717	8,772	11,342	14,306	16,691
Other German Imports	1,062	2,013	2,908	6,726	8,610
British Imports	4,033	6,771	9,789	14,519	19,653
Rover Group	2,880	5,166	7,371	10,655	14,431
Other British Imports	1,153	1,605	2,418	3,864	5,222
Swedish Imports	3,151	4,699	6,737	9,753	13,704
Volvo	2,228	3,265	4,634	7,122	10,915
Other Swedish Imports	923	1,434	2,103	2,631	2,789
French Imports	1,729	3,933	6,153	10,487	14,018
Italian Imports	3,046	3,832	4,216	4,564	5,933
Other Imports	137	221	529	1,724	2,354
Imported Makes	68,357	97,751	133,583	180,424	221,706
Total Registrations	3,146,023	3,274,800	3,717,359	4,403,749	5,102,659

*Includes minicars, defined as cars with an engine displacement of 550 cubic centimeters or less.

Source: Japan Automobile Manufacturers Association, *Motor Vehicle Statistics of Japan 1991.*

Automotive-state legislators on Capitol Hill were just as dismissive of the Japanese industry's parts purchasing and car sales plans as the Big Three executives had been. House Majority Leader Richard Gephardt (D, Mo.) was quoted as saying, "I didn't expect much and we didn't get much. Promises are no substitute for action, and in this case even the promises aren't worth much." He added: "The only way to get action is to continuously put pressure on the Japanese."

Rep. Gephardt already had prepared the means -- the Trade Enhancement Act, a variant of the measure he had pushed through the House when the 1988 trade act was being crafted. Unveiled December 20 and expected to be introduced in late January, the bill would require Japan to cut the 1991 bilateral trade deficit of roughly $42 billion by 20 percent a year for the next five years. If it came up short, the White House would cap the sale of domestically made and imported Japanese cars and trucks in 1992 at what Mr. Gephardt calculated was last year's level of 3.8 million units. The ceiling would apply to any vehicle with less than 60 percent of the value of its parts sourced from "traditional" American suppliers, and it would be lowered by 250,000 units each year that Japan failed to meet its deficit-reduction target.

The Gephardt initiative also would force the executive branch to do what the Department of Commerce's Auto Parts Advisory Committee has failed to achieve: self-initiate a dumping proceeding on Japanese-made automotive parts as well as an unfair trade practices investigation under Section 301 of the 1974 Trade Act of "Tokyo's toleration of systematic anti-competitive practices" in automotive parts (see *JEI Report* No. 30B, August 9, 1991). Under another provision the bill would direct the president to persuade Tokyo to extend its current quota on U.S.-bound car shipments to transplant production containing less than 60 percent "true" U.S. content; that is a longtime Chrysler and United Auto Workers union demand.

Despite broad support for the Trade Enhancement Act among House and Senate Democrats, passage of the bill in anything close to its original shape was questionable when the chairmen of the Big Three flew off to Tokyo to join other members of the business delegation accompanying President Bush. The odds of enactment improved when Messrs. Iacocca, Poling and Stempel returned home.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.